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## DIVISION OF BANKING

217 ½ West Missouri, Pierre, SD 57501  
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## MEMORANDUM

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NUMBER: 20-001

DATE: 06/11/08

TO: SOUTH DAKOTA BANKS

FROM: BRET AFDAHL, Division Counsel

RE: NEW LEGISLATION AND RULES

The 2008 legislative session was an active one for changes in South Dakota banking law. The following is a summary of the Senate Bill 17 (SB 17) that was passed out of both houses of the South Dakota Legislature and signed by the Governor. If you would like to read the text of SB 17, please go to <http://legis.state.sd.us/sessions/2008/Bills/SB17ENR.pdf>. If you would like additional information regarding SB 17 or have any questions you can contact the Division at 605-773-3421.

The changes made by SB 17 will become effective on July 1, 2008. Below is a summary of the substantive changes along with citations to the relevant portions of SB 17 for your reference.

### Senate Bill 17 (SB 17):

With the passage of SB 17, South Dakota banking law has been changed in three primary areas. First, the application process has been streamlined to transfer approval authority from the South Dakota Banking Commission (Commission) to the Director of the Division of Banking (Division). Second, the criteria an applicant must meet for an application has been updated to be more similar to the criteria used by the federal regulators. Finally, the outdated restrictions on branching have been updated or repealed to allow the market to dictate where and when banks can branch.

The application process has been amended to establish a new process and timeline for bank applications. See SB 17 section 7. The basic components of this process require a publication of notice of the application and a thirty day period for comment from the public. The Director must decide the application no later than 45 days from the date of publication. A fifteen day appeal period follows the Director's decision. This process will allow applications to be filed when they are ready instead of when the next meeting of the Commission is scheduled.

The criteria to be evaluated for each application has been amended to place more focus and attention on the management strength and condition of the applicant, and less on the "need" in the target community. See SB 17 section 12. Below is a list of the criteria contained in section 12 along with examples of the kind of information that will be reviewed by the Division:

- (1) The financial history and condition of the applicant (*review of balance sheet, income statement, financial ratios, historical trends, etc.*);
- (2) The adequacy of the applicant's financial structure (*capital level/trends, loan volume/trends, liquidity position, loan loss reserve balance, etc.*);
- (3) The future earning prospects of the applicant (*review of projected budget, business plan and associated assumptions, projected growth rates, timeline for plan implementation, lease and leasehold improvement costs, etc.*);
- (4) The general character and fitness of the management/ownership of the applicant (*banking experience, enforcement actions, bench strength, service to community, prior relationship with regulators, etc.*);

- (5) The applicant's ability to serve the community as described in the application (*business plan, proposed products/services, experience level, etc.*); and,
- (6) Other factors and circumstances (*prior enforcement actions, pending litigation, risks associated with current and proposed products/services, bank location, etc.*).

South Dakota has historically placed severe restrictions on branching activity, both intrastate and interstate. For intrastate branching, SDCL 51A-7-4 restricted branching activity based upon the population of the target community and the number and types of institutions located in that community. SB 17 will remove all population based branching restriction. See SB 17 section 30.

Interstate branching into South Dakota has been restricted by a 60 month requirement in SDCL 51A-7-16. The 60 month requirement restricted out of state banks from branching into South Dakota by requiring that such interstate branch could only be established through the purchase of a bank or branch location in South Dakota that had been in existence not less than 60 months. This restriction prohibited what is called "De novo" branching which is the establishment of a branch where one did not previously exist. This restriction will be removed to allow reciprocal de novo branching into South Dakota. See SB 17 section 37. An out of state bank will be allowed to branch into South Dakota to the same extent a South Dakota bank would be allowed to branch into the out of state bank's home state. If that state imposes the "60 month" rule on interstate branching, that out of state bank will be burdened in the same manner in its efforts to branch into South Dakota.

Additional changes brought about by SB 17 include: providing a definition in 51A-1-2 for "mobile branch bank" which was previously defined in rule; increased civil fines for failure to follow orders issued by the director or commission; reduced regular Commission meetings from four to two per year; updated language in removal and prohibition authority; provided the Director with the authority to waive any of the requirements in South Dakota banking law in the event of a natural disaster; a prohibition of the use of the word "bank" by non-bank entities in the advertisement of products; and the amendment of the statute of limitations for actions against bank employees, officers, directors, etc. from six to three years for errors, mistakes, and omissions.

#### Spring 2008 Rule Amendments:

The Banking Commission has adopted new rules that will become effective on July 1, 2008, to coincide with and to help implement some of the changes made in SB 17. Below is a summary of the rules adopted by the Commission that will directly impact our state banks. If you would like to read the text of the rules, please go to:

[http://www.state.sd.us/drr2/reg/bank/commission/rules\\_all.pdf](http://www.state.sd.us/drr2/reg/bank/commission/rules_all.pdf).

The rule related to charge-offs was amended to remove the requirement that 50 percent of assets classified as doubtful be charged off within 30 days of the receipt of the report of examination. See Page 6 of the Rules in the link above, ARSD 20:07:03:16. This change was made to bring the rule into compliance with GAAP and the Call Report Instructions.

The rule regarding the allowance for loan and lease losses (ALLL), which was previously called the reserve for loan and lease losses, was completely re-written. See Rules pages 6 & 7, ARSD 20:07:03:17. This rule was rewritten to take into account FAS 5 & 114 and the shift in terminology from "adequate" to "appropriate" and the requirement of impairment testing.

Several rules that provided special authority for investments in certain types of real estate and business ventures were repealed. See Rules pages 8 & 9, ARSD 20:07:03:19 through 20:07:03:22. These rules were repealed because the statutes that these rules sought to implement were repealed by SB 17.

Rules related to our application process were amended to reflect the changes made in SB 17. The first reduces the number of copies of applications that must be submitted to the Division from

eight to four. See Page 10, ARSD 20:07:10:03. The other change removes the reference to “need of the community” from the rule dictating the minimum capital required for branch banks. See Rules pages 11 & 12, ARSD 20:07:10:07.

The rule that restricts the activities at loan production offices (LPO) was amended to gain parity with the activities authorized for national banks. Specifically, the prohibition on credit decisions being made at an LPO location was deleted from the rule. See Rules page 15, ARSD 20:07:14:01.

The entire chapter dealing with the treatment of losses has been repealed. See Rules pages 16-19, ARSD 20:07:17:01 through 20:07:17:07. Like the rules regarding special investments, the statutory authority for the treatment of loss rules was repealed by SB 17. Guidance for the treatment of losses is provided by GAAP and the Call Report Instructions.

Finally, the chapter of rules dealing with mobile banking has been updated to reflect the changes in SB 17. The title of this chapter has been changed to “Mobile Branch Banks” and the definition in rule 20:07:23:01 was deleted to reflect the new definition provided in statute. See SB 17 section 1; Rules page 29. The application process to establish a mobile branch bank was amended to bring it into line with the application process established in SDCL 51A-2-16 and the criteria in 51A-3-9. See SB 17 sections 7 & 12; Rules page 30, ARSD 20:07:23:03.

If you should have any questions or if you should need additional information please feel free to contact the Division of Banking.